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IN THE

Supreme Court of the United States,

OCTOBER TERM—1932.

Nos. 476, 477, 478.

D. B. HEINER, Collector of Internal Revenue for the 23rd District of Pennsylvania,

Petitioner,

vs.

DIAMOND ALKALI COMPANY, a corporation.

C. G. LEWELLYN, formerly Collector of Internal Revenue for the 23rd District of Pennsylvania,

Petitioner,

vs.

DIAMOND ALKALI COMPANY, a corporation.

BRIEF OF DIAMOND ALKALI COMPANY IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI.

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THE BALLOU PRESS NEW YORK

SUBJECT INDEX.

PAGE

Brief in Opposition to Petition for Writs of Certiorari.. 1
Opinions Below 2
Jurisdiction 2
Question Presented 2
Statutes Involved 2
Statement 3

ARGUMENT

POINT I. The decision of the Circuit Court of Appeals does not conflict with principles announced by this Court or by other Circuit Courts 5

POINT II. The decision of the Circuit Court of Appeals is not erroneous; on the contrary it is correct and judgments for any less would be unconscionable 8

POINT III. The question involved is not an important one 13

CONCLUSION 14

Table of Cases Cited.

PAGE

Brown's "Shamrock" Linens, Ltd. v. Bowers, 48 Fed. (2nd) 103 6

Chalmers Publishing Co. v. Commissioner, 1 B. T. A. 629 12

Cleveland Automobile Co. v. United States (Feb. 24, 1932, N. D. Ohio, not yet reported) 7

Eisner v. Macomber, 252 U. S. 189..... 9

Miles v. Safe Deposit & Trust Co., 259 U. S. 247..... 9

Oak Worsted Mills v. United States, 38 Fed. (2nd) 699. 6

Standard Rice Co. v. Commissioner, 41 Fed. (2nd) 481.. 6

U. S. v. Supplee-Biddle Hardware Co., 265 U. S. 189.... 9

Williamsport Wire Rope Co. v. United States, 277 U. S. 551 .....5, 6, 10, 12, 13

Table of Statutes Cited.

Section 240(a), Judicial Code (43 Stat. 938; 28 U. S. C. A. Sec. 347) 2

Sections 327 and 328, Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1093) 2, 3, 9

Section 301, Revenue Act of 1918 .....11, 12

Section 327(d), Revenue Act of 1918 12

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BRIEF OF DIAMOND ALKALI COMPANY IN OPPOSITION TO PETITION FOR WRITS OF CERTIORARI.

The Solicitor General heretofore filed in this court a petition for writs of certiorari to the Circuit Court of Appeals for the Third Circuit to review the judgments of that court entered on July 26, 1932 (R. 181, 187, 193, Nos. 4419 & 4426; R. 124, 130, 135, No. 4427). One judgment was entered in the *Lewellyn* case which related to the taxable year 1919.

Two judgments, identical in terms, were entered in the *Heiner* case, disposing of the cross appeal of Collector Heiner and the appeal of the taxpayer.

Opinions Below.

The opinion of the District Court disposing of both cases is recorded in 39 Fed. (2nd) 645. Both the original opinion and the opinion upon reargument of the Circuit Court of Appeals are reported in 60 Fed. (2nd) 505 (R. 169, 188, Nos. 4419 & 4426; R. 112, 131, No. 4427).

Jurisdiction.

The jurisdiction of this court is invoked under Section 240(a) of the Judicial Code (43 Stat. 938; 28 U. S. C. A. Sec. 347).

Question Presented.

The petition for writs of certiorari does not accurately state the question presented. Such question may be more accurately stated as follows: Whether the Court's disability to review or change excess profits tax rates as found by the Commissioner under Section 328 (special assessment) shall be extended so as to prohibit the Court from correcting errors in income made by the Commissioner and from performing the simple mathematical operation of applying the Commissioner's rates to the true income.

Statutes Involved.

The statutes involved are Sections 327 and 328 of the Revenue Act of 1918 (c. 18, 40 Stat. 1057, 1093). Section 328 is set out in full at page 13 of the petition and Section 327 is set out in part on the same page. The whole of Section 327 is pertinent and it is as follows:

"SEC. 327. That in the following cases the tax shall be determined as provided in section 328:

"(a) Where the Commissioner is unable to determine the invested capital as provided in section 326;

"(b) In the case of a foreign corporation;

"(c) Where a mixed aggregate of tangible property and intangible property has been paid in for stock or for stock and bonds and the Commissioner is unable satisfactorily to determine the respective values of the several classes of property at the time of payment, or to distinguish the classes of property paid in for stock and for bonds, respectively;

"(d) Where upon application by the corporation the Commissioner finds and so declares of record that the tax if determined without benefit of this section would, owing to abnormal conditions affecting the capital or income of the corporation, work upon the corporation an exceptional hardship evidenced by gross disproportion between the tax computed without benefit of this section and the tax computed by reference to the representative corporations specified in section 328. This subdivision shall not apply to any case (1) in which the tax (computed without benefit of this section) is high merely because the corporation earned within the taxable year a high rate of profit upon a normal invested capital, nor (2) in which 50 per centum or more of the gross income of the corporation for the taxable year (computed under section 233 of Title II) consists of gains, profits, commissions, or other income, derived on a cost-plus basis from a Government contract or contracts made between April 6, 1917, and November 11, 1918, both dates inclusive."

Statement.

The taxpayer duly filed income and profits tax returns for the calendar years 1918 and 1919. On the face of the return filed for 1918 claim was made that its profits taxes should be computed under Sections 327 and 328 of the Revenue Act of 1918 (Ex. LL, B. E. Vol. II, p. 635). Thereafter

a similar claim was made with respect to the year 1919. The Commissioner determined that owing to abnormal conditions the profits taxes, if determined in the ordinary way, would work an exceptional hardship upon the taxpayer evidenced by gross disproportion between the tax as computed in the ordinary way and the tax as computed by special assessment. The taxpayer offered to prove at the trial that the abnormality upon which special assessment was conditioned was an abnormality of capital and not of income for the purpose of establishing that any change in income could not remove the abnormality. On objection by the petitioners this evidence was rejected (B. E. Vol. 1, p. 222).

The Commissioner found that the ratio of tax to income (tax rate) should be 54.54% for 1918 and 18.31% for 1919, arriving at such rates by taking the average rates of representative corporations.

The Commissioner made large income adjustments, determined deficiencies, assessed and collected the same, and in due course rejected the taxpayer's claims for refund. The taxpayer brought suits in the District Court for the Western District of Pennsylvania which court increased the deduction allowed by the Commissioner for amortization of war facilities but denied the other claims made by the taxpayer. The District Court applied the profits tax rates found by the Commissioner to the income as corrected by it.

On appeal the Circuit Court of Appeals increased the deduction for amortization of war facilities, but in its original opinion held that, notwithstanding the reduction of income, the profits taxes as found by the Commissioner should not be reduced. On rehearing the Circuit Court of Appeals found that the taxpayer was entitled to an additional deduction for depreciation in 1918 and that the profits tax rates as found by the Commissioner should be applied to the corrected net income in order to determine the correct profits tax liability of the taxpayer for each year in question.

The petitioners now ask this Court to review the final decision of the Circuit Court of Appeals and to hold that,

notwithstanding substantial reductions in income (more than $500,000 for 1918 and more than $100,000 for 1919), the profits taxes found by the Commissioner should nevertheless remain the same.

ARGUMENT.

POINT I.

The decision of the Circuit Court of Appeals does not conflict with principles announced by this Court or by other Circuit Courts.

The primary reason advanced by the petitioners for granting writs is that the decision below conflicts with the decision of this Court in *Williamsport Wire Rope Co.* v. *United States*, 277 U. S. 551.

In that case the sole question presented was whether or not the Court of Claims could review the Commissioner's determination that the taxpayer did not present a special case requiring that its profits tax rate be determined by reference to representative corporations. In its opinion this Court pointed out that the question presents such a complex and delicate phase of revenue administration that review by a large number of courts would tend to defeat rather than promote equality of application of the relief provisions, because the courts would not have ready access to the necessary, voluminous data and because their experience in passing upon questions of that kind is limited. The decision emphasizes the necessities and practicalities of the situation rather than jurisdiction. As a practical matter the courts would be unable to determine whether the Commissioner erred in his selection of comparatives or representative corporations unless they had unlimited access to the files of the Commissioner. It would be impossible for trial courts to obtain all this data and impracticable to consider

it even if it were obtainable. It is true the delegation of this work to the Commissioner removes it from the hands of the courts, but they are not thereby deprived of jurisdiction to correct other errors in the case of any taxpayer whose profits tax rates have been determined from representative corporations. While the question before the Court was the right to special assessment, the decision clearly applied also to the equally delicate and complex matter of ascertaining the tax rate from representative corporations, and this Court has declined to review that question in the absence of irregularity. *Brown's "Shamrock" Linens, Ltd.* v. *Bowers*, 48 Fed. (2nd) 103 (C. C. A. 2nd), cert. denied, 283 U. S. 865.

Once the delicate and complex questions of whether special assessment should be granted and, if so, what the rate should be are decided as an administrative matter, certainly nothing delicate or complex is left in multiplying such rate by the correct net income and nothing that this Court has said and no principle that this or any other Court has announced can be so construed.

Since the decision in the *Williamsport Wire Rope* case many cases have come before the courts either on original jurisdiction or by appeal from the Board. Most of them involved either the denial of special assessment or the propriety of the rate found by the Commissioner. *Brown's "Shamrock" Linens, Ltd.*, v. *Bowers*, 48 Fed. (2nd) 103 (C. C. A. 2nd), cert. denied 283 U. S. 865, was a case of a foreign corporation which did not complain of the income found by the Commissioner but was solely concerned with the rate. *Standard Rice Co.* v. *Commissioner*, 41 Fed. (2nd) 481 (C. C. A. 5th), held that where the Board sustained the Commissioner's denial of special assessment the Court would not review on an appeal from the Board. *Oak Worsted Mills* v. *United States*, 38 Fed. (2nd) 699 (Ct. Cls.), merely held the obvious, namely, that the Commissioner could, within the statutory period of limitation, revise his computation of the tax under special assessment. Other cases

cited in the petition were confined entirely to the questions of denial of special assessment, the propriety of the rate, or whether or not the Commissioner had acted in a manner so arbitrary as to constitute abuse of discretion. None went any further. None purported to decide or even to imply that there is discretion in the simple act of multiplying an income by a rate.

The question here involved was not present in any of the cases that have been decided either by this Court or the Circuit Courts of Appeals.

The question was considered but not decided in one District Court case, *Cleveland Automobile Company* v. *United States* (Feb. 24, 1932, N. D. Ohio, not yet reported). That case was one in which the taxpayer contended that the Commissioner had improperly valued its inventory and thereby overstated its income. The Government defended on the grounds that the inventory had been correctly determined by the Commissioner and that in any event income could not be revised by the Court because the profits tax had been determined by special assessment. While the Court expressed doubt as to whether it could change the income it finally concluded that on the merits there was no error in the Commissioner's determination of income. This finding as to the correctness of the income was necessary to any decision of the case because even if the Court had believed it could not change the income for profits tax purposes it unquestionably must have known that it had jurisdiction to change the income for income tax purposes since the income taxes are never a matter of special assessment. Therefore, all that the court said regarding its jurisdiction over the profits tax became dictum. We are impelled, however, to go further and point out that the court did not have before it the full significance of the matter for, in the course of its opinion, it suggested that the income must have been correct for purposes of the profits tax under special assessment since the taxpayer, an automobile dealer, was no doubt compared with other automobile dealers who must have had the same inventory problems and whose income,

therefore, presented the same problem as the taxpayer's. This is an obvious misconception because income is not determined from representative corporations. It is required to be determined on the merits and only the average ratio or rate of profits taxes paid by representative corporations is employed in determining the profits tax of a taxpayer under special assessment. Therefore it is apparent that both on its reasoning and because its discussion of the instant question was dictum the decision of the District Court does not conflict with the decision in the cases at bar.

Accordingly it is submitted that the petitioners' primary ground, namely, conflict between the decision below and other decisions, is without merit.

POINT II.

The decision of the Circuit Court of Appeals is not erroneous; on the contrary it is correct and judgments for any less would be unconscionable.

In opposition to the second ground presented in the petition we assert that the correctness and justice of the decision is clearly demonstrable and further that petitioners' claim is unjust, resulting in a delegation of power to the Commissioner that can not be presumed in the absence of clear and compelling statutory language. Their position leads to startling results when examined.

Petitioners contend that the profits taxes found by the Commissioner must not be disturbed even though income is reduced. In the exercise of his discretionary power he found the rate for 1918 at 54.54% and applying this to his concept of the net income found a profits tax for that year of $2,084,324.26. The Court below reduced the net income of $3,821,134.63 found by the Commissioner by $529,733.33 or to

the correct net income of $3,291,401.30. The Commissioner's profits tax is not 54.54% of the correct net income, *but is more than 63% thereof.* With different figures the result in 1919 is similar. If the profits tax must be left undisturbed the effect is either: (1) the courts do not have jurisdiction to correct any errors of income once a profits tax has been computed by special assessment; or, (2) the courts in order to sustain the Commissioner's assessment must apply a higher rate of profits tax whenever income is reduced to the correct amount.

Denial to taxpayers of the right to have a court review the Commissioner's determination of income wherever the Commissioner computed the profits tax rate by special assessment would be far reaching. Profits tax rates must be determined from representative corporations in the case of (1) all foreign corporations, (2) all corporations whose invested capital cannot be determined, (3) all corporations whose capital paid in consisted of tangible and intangible property not clearly severable, and (4) all corporations which had an abnormality of capital or income, or both, that resulted in a gross disproportion in their profits tax rate computed in the ordinary way when compared with the profits tax rates of representative corporations (See Section 327, *ante*). The claim of the petitioners in essence is that in all classes of cases enumerated above the Commissioner is intended to be the sole and final judge of what constitutes income under the Sixteenth Amendment, how much the income is in any case, and what deductions taxpayers are entitled to take. It would confer upon the Commissioner the authority to decide constitutional questions without review and to tax that which is constitutionally not income, such as stock dividends from foreign corporations received by domestic corporations, stock rights similarly received, proceeds of life insurance upon an officer of a corporation and the like. Compare *Eisner* v. *Macomber*, 252 U. S. 189; *Miles* v. *Safe Deposit & Trust Co.*, 259 U. S. 247; *U. S.* v. *Supplee-Biddle Hardware Company*, 265 U. S. 189. Carried to its logical conclusion the petitioners' con-

reduce it. Therefore, when the court fixed the profits tax by the simple process of multiplication at 75% of the corrected net income of 1919, for example, it merely gave the taxpayer so much of the relief to which it was entitled as the court was empowered to give.

The petitioners argued below that the changing of the income might produce a situation where the computations used for the lower income would not be correct. However, this reduction in income, which would carry with it a reduction in the profits per unit of business mentioned in the statute, would not result in a change in capital or a change in the nature of the business, or in any other important factor incident to the selection of comparatives. Only two factors, income and capital, can affect the profits tax rate. In this case there was no change of capital. Therefore, comparatives selected to reflect the situation of a reduced income must show a lower rate than that shown by proper comparatives selected to fit the situation of a greater income. And this would be true in all cases involving this question.

This taxpayer brought its suits in the District Court before it was decided that a review of special assessment rates fixed by the Commissioner was withheld from the Courts by Congress. Having suffered that misfortune it is now forced to accept the rate of 75% for 1918 and 1919, for 1919 instead of having the right to reduce rates to accord with the reduced income. Accordingly, it does not lie in the mouths of the petitioners to assert that the judgments of the court below are erroneous. The judgments apply assessable profits tax rates to corrected income. The result is just and fair so far as the Court's power to review permits. To deprive it of the power of reaching this result would be unconscionable.

In a footnote on page 11 of the petition it is stated that a computation by the Bureau of Internal Revenue shows that profits taxes computed under Section 301, that is, without special assessment, would be more on the basis of the re-

duced income than the profits taxes paid by the taxpayer. This statement off the record is apparently made in order to suggest to the Court that it should now reverse the Commissioner's allowance of special assessment and recompute the tax under Section 301 in order to decide whether or not the taxpayer is entitled to a refund. The clear answer to this suggestion, however, is that where any of the conditions set forth in Section 327 exist the profits tax rate *must* be computed under Section 328 since the provisions of that section are not permissive but mandatory. It has already been pointed out that the abnormality in these cases is one of capital and the only change made by the court is in income. The abnormality, one of the conditions of special assessment, therefore remains. The figures in the footnote, if correct, serve to show that the tax computed under Section 301 would be grossly disproportionate to the tax computed under Section 328, even using the unreviewable rates which on reason are too high. Such figures thus establish the other condition of special assessment under Section 327 (d), namely, a gross disproportion between the taxes computed by the two methods.

On the same page of the petition it is stated that the Commissioner gives taxpayers opportunity to withdraw the request for special assessment if they are not satisfied with the income found by him, citing *Chalmers Publishing Co.* v. *Commissioner*, 1 B. T. A. 629. That case does not in any conceivable sense support the assertion. Since special assessment is mandatory if the conditions set forth in Section 327 exist, it would be impossible for the Commissioner validly to give any such right to taxpayers. Subsections (a), (b) and (c) of Section 327 require the use of Section 328 in any event. Subsection (d) requires such use when the abnormality and the gross disproportion are found. We, therefore, challenge the existence of any such custom and deny that it could be proper under the statute.

Under the *Williamsport* decision neither the Commissioner's refusal to grant special assessment nor the profits tax

rate found by him if he has granted special assessment is subject to court review provided the Commissioner has properly exercised his discretionary power. But the petitioners now seek a decision by this Court that, special assessment having been granted and a rate determined, plain errors in income may not be reviewed or corrected by the courts. The ascertainment of the correct net income under the law embraces matters of fact and law which are not limited by administrative discretion. Certainly taxpayers of this country are not to be deprived of all judicial review and remedy when their money has been exacted on the basis of mistakes of an administrative bureau in ascertaining facts or construing statutes. A direct attempt by Congress to do such a thing would be shocking. This attempt to read such an intent into purely relief provisions of the statute is even more shocking.

POINT III.

The question involved is not an important one.

The petition, for its third ground, states that this question is presented in pending cases involving some $2,000,000. Apparently that amount does not turn on this question alone, but is the amount involved in pending cases in which this question among others may be presented. In any event, this question, involving as it does only the war tax years, would seem to be of very narrow present or future application. It must soon be a dead issue. In fact it was never a live issue before these cases in which it was raised by the Government for the first time. No useful purpose can now be served by granting the petitioners an opportunity to ask that this Court extend the *Williamsport Wire Rope* decision so as to produce a demonstrably unjust and unconscionable result.

Under the third ground it is also suggested in vague, general terms that this question bears upon the Commissioner's discretionary powers under later Revenue Acts. No spe-

cific reference is made to the powers or the Acts conferring them. A careful scrutiny of all the later acts does not disclose any grant of administrative discretion which could be affected even remotely by the decision below or by a decision of this court.

CONCLUSION.

It is respectfully submitted that these cases do not warrant a review by this Court.

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